

## Company Focus

31 January 2008 | 11 pages

# Asian Paints (ASP.N.BO)

 Target price change   
 Estimate change   
 Results 

## Buy: All Cylinders Firing – Raise Target Price to Rs1335

- All cylinders firing** – ASPN is one of the best plays on domestic consumption demand in India and is firing on all cylinders – its domestic paints business is growing in excess of 20%, international business improvement is running ahead of management guidance and cost pressures seem to be abating, resulting in improving margins.
- Domestic growth in a higher trajectory** – ASPN's domestic sales growth has been growing by 15%-25% over the last 8 quarters, demonstrating a strong improvement over the 10%-15% growth range earlier. This growth is boosted by a strong demand environment, new product rollout and change in Asian Paints' positioning from a 'mass' to a 'premium' brand.
- International business turnaround** – Growth in the international business has also picked up, and margins have started to improve, driven by the Middle-East and South Asian markets. International business net margins are already in excess of 3%, ahead of management targets to achieve 3% in FY09E.
- Margin pressure abating** – Potential duty cuts expected on raw material imports and price hikes are likely to drive margin expansion – management has indicated that a 1%-2% price hike is imminent.
- Raising target price** – We raise our target price to Rs1335, based on 25x FY09E P/E. Our increase in price target is based on the increase in our EPS estimates for FY08E-FY10E by 19%-23% following better than expected 9mFY09 performance and management guidance for higher margins.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (29 Jan 08)	Rs1,104.45
Target price	Rs1,335.00
	<i>from Rs1,102.00</i>
Expected share price return	20.9%
Expected dividend yield	2.4%
<b>Expected total return</b>	<b>23.2%</b>
Market Cap	Rs105,939M
	US\$2,696M

### Price Performance (RIC: ASPN.BO, BB: APNT IN)



### Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2006A	2,208	23.02	26.5	48.0	16.4	36.4	1.1
2007A	2,861	29.84	29.6	37.0	13.6	40.2	1.2
2008E	4,164	43.42	45.5	25.4	11.8	49.8	2.4
2009E	5,120	53.39	23.0	20.7	10.5	53.7	3.1
2010E	6,190	64.55	20.9	17.1	9.4	57.8	3.8

Source: Powered by dataCentral

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<sup>1</sup>Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
<b>Valuation Ratios</b>					
P/E adjusted (x)	48.0	37.0	25.4	20.7	17.1
EV/EBITDA adjusted (x)	27.6	22.5	16.5	13.5	11.2
P/BV (x)	16.4	13.6	11.8	10.5	9.4
Dividend yield (%)	1.1	1.2	2.4	3.1	3.8
<b>Per Share Data (Rs)</b>					
EPS adjusted	23.02	29.84	43.42	53.39	64.55
EPS reported	22.12	29.30	43.42	53.39	64.55
BVPS	67.39	81.10	93.27	105.55	117.82
DPS	12.50	13.00	26.05	34.71	41.96
<b>Profit &amp; Loss (RsM)</b>					
Net sales	30,210	36,700	44,071	51,976	60,453
Operating expenses	-26,900	-32,530	-38,217	-44,694	-51,571
<b>EBIT</b>	<b>3,311</b>	<b>4,169</b>	<b>5,854</b>	<b>7,282</b>	<b>8,883</b>
Net interest expense	-114	-189	-202	-198	-198
Non-operating/exceptionals	311	368	596	596	596
<b>Pre-tax profit</b>	<b>3,507</b>	<b>4,349</b>	<b>6,248</b>	<b>7,680</b>	<b>9,280</b>
Tax	-1,323	-1,467	-2,062	-2,534	-3,062
Extraord./Min.Int./Pref.div.	-63	-72	-23	-25	-27
<b>Reported net income</b>	<b>2,121</b>	<b>2,810</b>	<b>4,164</b>	<b>5,120</b>	<b>6,190</b>
Adjusted earnings	2,208	2,861	4,164	5,120	6,190
Adjusted EBITDA	3,917	4,781	6,509	7,986	9,622
<b>Growth Rates (%)</b>					
Sales	18.0	21.5	20.1	17.9	16.3
EBIT adjusted	24.4	25.9	40.4	24.4	22.0
EBITDA adjusted	16.9	22.1	36.2	22.7	20.5
EPS adjusted	26.5	29.6	45.5	23.0	20.9
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>2,448</b>	<b>2,791</b>	<b>4,188</b>	<b>5,154</b>	<b>6,122</b>
Depreciation/amortization	606	611	655	704	739
Net working capital	-205	-579	-836	-696	-835
<b>Investing cash flow</b>	<b>-1,233</b>	<b>-1,405</b>	<b>-526</b>	<b>-932</b>	<b>-644</b>
Capital expenditure	-755	-1,025	-1,005	-932	-644
Acquisitions/disposals	-239	-190	240	0	0
<b>Financing cash flow</b>	<b>-1,199</b>	<b>-1,097</b>	<b>-3,098</b>	<b>-3,943</b>	<b>-5,013</b>
Borrowings	218	449	-101	0	0
Dividends paid	-1,370	-1,428	-2,498	-3,328	-4,024
<b>Change in cash</b>	<b>16</b>	<b>289</b>	<b>564</b>	<b>279</b>	<b>465</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>17,062</b>	<b>20,241</b>	<b>23,539</b>	<b>26,319</b>	<b>29,020</b>
Cash & cash equivalent	734	1,054	1,595	1,849	2,287
Accounts receivable	3,475	4,206	5,011	5,838	6,625
Net fixed assets	4,518	4,932	5,281	5,509	5,413
<b>Total liabilities</b>	<b>9,999</b>	<b>11,862</b>	<b>13,894</b>	<b>15,497</b>	<b>17,021</b>
Accounts payable	5,787	7,870	8,826	10,253	11,789
Total Debt	2,613	3,062	2,961	2,961	2,961
<b>Shareholders' funds</b>	<b>7,063</b>	<b>8,378</b>	<b>9,645</b>	<b>10,822</b>	<b>11,999</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	13.0	13.0	14.8	15.4	15.9
ROE adjusted	36.4	40.2	49.8	53.7	57.8
ROIC adjusted	22.9	29.6	36.5	39.7	45.2
Net debt to equity	26.6	24.0	14.2	10.3	5.6
Total debt to capital	27.0	26.8	23.5	21.5	19.8

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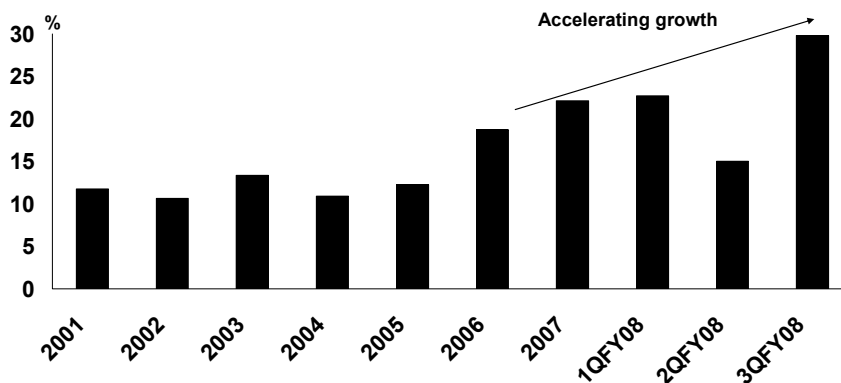
## Firing on All Cylinders

Asian Paints is firing on all cylinders – its domestic paints business is growing in excess of 20%, international business improvement is running ahead of management guidance and cost pressures seem to be abating, resulting in improving margins.

1. **Domestic decorative paints business:** Asian Paints' domestic decorative paints growth has accelerated into a higher growth orbit. Over the last 2 years domestic sales growth has accelerated to 15%-25% range from 10%-15% earlier. This has been driven by an increase in construction activity in India, rising consumer demand for re-painting as well as introduction on new products by Asian Paints. In addition, we believe that Asian Paints' strategy to reposition its brand has also started to bear fruit. In 2002, the company started its brand repositioning exercise, dropping its brand mascot 'Gattu', which was positioned toward the mass market. In addition the company also added high-end paints to its portfolio, under the 'Royale' brand, which has been marketed heavily of late. The repositioning exercise is paying off, and we believe that consumers perceive Asian Paints as a 'premium brand', even though its product range straddles a wide price band. As a result of its strong brand equity, Asian Paints continues to be the market leader in the decorative paints segment, despite premium pricing over competition. In addition, Asian Paints is also the price leader in the market, and typically, competition follows its price changes.

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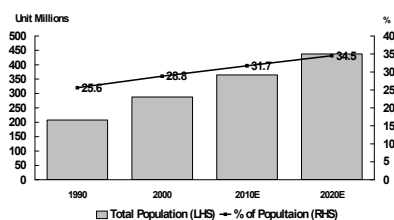
Figure 1. Asian Paints Domestic Business Growth Trend (% YoY)



Source: Company Reports and CIR

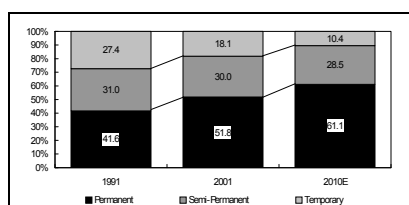
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Figure 2. Urbanization Trend in India



Source: India demographics report

Figure 3. Composition of Housing Stock in India



Source: Census of India; CIR estimates

The key drivers to sustain strong demand growth for paint are in place. The rise in urbanization, higher disposable incomes, lower cost of housing loans and a shift from semi-permanent to permanent housing structures are key factors that affect demand for paint, directly or indirectly. All these factors are conducive to sustaining demand growth for paint in India over the longer term. However, it needs to be noted that favorable demographics alone are not enough to sustain long-term demand growth. Of the overall demand for paint in the housing sector, almost 70% is for repainting (from existing housing stock), while only 30% is for new housing. Consumer attitudes and awareness of painting aesthetics in India are at a low level with low paint usage and a typical 5-year plus repeat purchase. However, with changing aspirations of a young population, the replacement cycle is shrinking and enhancing demand growth.

Rising urbanization and an increase in the number of nuclear families has triggered demand for housing. Rising income levels and increased availability of cheap housing finance options have led to increased affordability for housing. This has fueled growth in the housing sector over the last three years. We believe housing sector growth is here to stay.

Another important factor driving paint demand is the changing composition of the household stock. The proportion of permanent houses that require some form of paint has been increasing in the overall housing stock. The total number of houses in India as per Census 2001 was 249m and the CAGR over 10 years (1991-2001) was about 2.5%. However, the number of permanent houses (ones with a roof and walls made of some sort of concrete material) was only 99m in 2001 (up from 63m in 1991, CAGR of 4.6%). We believe the transition from semi-permanent structures to permanent structures will continue at a rate much faster than the overall addition of houses and drive demand for home products like paint.

- International business:** Asian Paints has a presence in 22 countries outside India through acquisitions, joint ventures and greenfield projects. Of these, Asian Paints gained entry into 11 countries (China, Southeast Asia, the Middle East and the Caribbean islands) when it acquired a majority stake in Berger International in 2002. Over the years, focus on international business has been to improve margins, while at the same time living off areas where the company does not see any significant profitability potential. However, of late the international business has been facing raw material cost pressures, part of which have been mitigated through sourcing and formulation efficiency gains. International business growth and margins have started to pick up, driven by strong performance in the Middle East and South Asian markets, particularly Bangladesh and Sri Lanka. Asian Paints management had targeted a 3% net margin for the international business by FY09E, which has been achieved ahead of schedule.
- Margins looking up:** Asian Paints has been facing margin pressure over the last two years owing to raw material cost pressures. Management has been able to mitigate the margin pressure through selective price hikes. However, with some raw material prices stabilizing of late, improving profitability in the international business and price hikes are driving margin improvement, a trend we expect to continue. EBITDA margins have been

over the last few quarters, and the trend has intensified, with margins improving 250bps in 3QFY08. Management has indicated that the margin improvement trend will continue in the near future.

## Raising Target Price to Rs1335

We are raising our target price on Asian Paints to Rs1335 from Rs1102 as we revise our earnings upwards. Our target price is based on a target multiple of 25x FY09E earnings. Our earnings increase of 18.5-22.9% over FY08E-10E is driven by better than expected 9MFY08 performance of Asian Paints, robust demand outlook for all the key operating segments and improving margin expectations.

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**Figure 4. Earnings Revision Summary**

Year to	Net Profit (Rs Mils.)			Diluted EPS (Rs)			Dividend Per Share (Rs)		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
31-Mar									
2008E	3,512	4,164	18.5%	36.62	43.42	18.5%	19.1	26.0	36.6%
2009E	4,227	5,120	21.1%	44.08	53.39	21.1%	22.2	34.7	56.5%
2010E	5,036	6,190	22.9%	52.51	64.55	22.9%	25.6	42.0	63.7%

Source: Citi Investment Research

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## 3QFY08 Result Review

Asian Paints 3QFY08 consolidated profit growth of 66% was ahead of our expectations of a 26% growth. The key surprises were: (1) Stronger than expected sales growth of 26% driven by robust demand in the decorative segment in the festive season, which also benefited from the low base of last year (which had the festive season falling in 2Q), (2) 257bp EBITDA margin expansion and (3) higher than expected other income, which grew by 73% this quarter.

Figure 5. Consolidated Asian Paints: 3QFY08 Result Details ( Rupees in Million, Percent)

	3QFY07	3QFY08	% yoy
<b>Net Sales</b>	<b>9,356.4</b>	<b>11,776.4</b>	<b>25.9</b>
Expenditure	-8,122.0	-9,920.5	22.1
<b>EBITDA</b>	<b>1,234.5</b>	<b>1,855.9</b>	<b>50.3</b>
<i>EBITDA Margin (%)</i>	<i>13.2</i>	<i>15.8</i>	<i>257 bps</i>
Interest	-56.5	-54.3	(4.0)
Depreciation & Amortisation	-146.7	-150.2	2.4
Other Income	76.3	131.8	72.6
<b>PBT</b>	<b>1,107.6</b>	<b>1,783.2</b>	<b>61.0</b>
Tax	-357.3	-536.9	50.3
<i>Tax Rate (%)</i>	<i>32.3</i>	<i>30.1</i>	<i>-215 bps</i>
<b>PAT</b>	<b>750.3</b>	<b>1,246.3</b>	<b>66.1</b>
Exceptional items & Minority interest	-36.3	-57.6	58.7
<b>PAT after Exceptionals</b>	<b>714.0</b>	<b>1,188.7</b>	<b>66.5</b>
No of shares	95.9	95.9	
<b>EPS</b>	<b>7.8</b>	<b>13.0</b>	<b>66.1</b>
<b>Cost Details</b>	<b>3QFY07</b>	<b>3QFY08</b>	<b>% yoy</b>
Total Raw Material Cost	5,685.7	6,908.6	21.5
<i>% of Sales</i>	<i>60.8</i>	<i>58.66</i>	<i>-210 bps</i>
Employee/Staff Cost	652.2	762.6	16.9
<i>% of Sales</i>	<i>7.0</i>	<i>6.5</i>	<i>-49 bps</i>
Other Expenditure	1,784.0	2,249.3	26.1
<i>% of Sales</i>	<i>19.1</i>	<i>19.1</i>	<i>3 bps</i>

Source: Company Reports

## Asian Paints

### Company description

Asian Paints is the market leader in India's decorative paints industry, accounting for 47% of the total revenues of the top six companies in the organized segment. Asian Paints also caters to the industrial paints segment, and has a presence in 22 countries, including South Asian countries, China, Australia, the Caribbean and the Middle East. Asian Paints has strong brands, a wide range of offerings across all product categories, and the most extensive distribution network in the Indian paints industry.

### Investment strategy

The rise in urbanization, higher disposable incomes, cheaper housing loans and a shift from semi-permanent to permanent housing structures are driving the paints market at over 1.5x GDP growth. Asian Paints enjoys competitive advantages that should help it outpace the market — strong brands, a wide range of offerings across all product categories, and the most extensive distribution network in the paints industry. The company is leveraging off its local expertise to improve the performance of the assets acquired abroad. The Berger acquisition in 2002 increased the share of revenues from the overseas ventures to more than 20% of group sales, from 5%. Over the past 10 years, Asian Paints' profit CAGR has been 15%; we expect this to pick up over the next three years.

## Valuation

We prefer P/E as our primary valuation tool because the company operates in a non-cyclical industry. Being the market leader, the company also has reasonable pricing power. Historically, the stock has traded at an average of 16x one-year rolling forward EPS for the standalone entity. However, we believe the stock is a re-rating candidate (especially with international operations turning around and local growth accelerating) and could trade at over 20x-25x P/E, the higher end of its historical trading band. Our target price of Rs1335 is based on 25x FY09E consolidated EPS. Our target multiple reflects the pickup in the growth profile of Asian Paints' domestic paints business and increasing profitability of the international and industrial coatings businesses. Our 25x target multiple is in line with what we attribute to other mid-cap consumer stocks in our universe that have similar growth and ROE characteristics.

## Risks

We rate Asian Paints as Low Risk based on our quantitative risk-rating system. The main downside risks that could impede the stock from reaching our target price include: (1) Integration risks include streamlining of operations and integrating employees; (2) Asian Paints has operations in 22 countries outside India, therefore any wild currency fluctuation could hurt profitability; (3) If economic growth slows, it would affect demand for paints; (4) If Asian Paints is unable to aggressively respond to recent moves from the competition, it could lose market share; and (5) Raw materials constitute almost 57% of Asian Paints' total operational costs. A major part of raw-material prices is linked to global oil and petrochemical prices.

# Appendix A-1

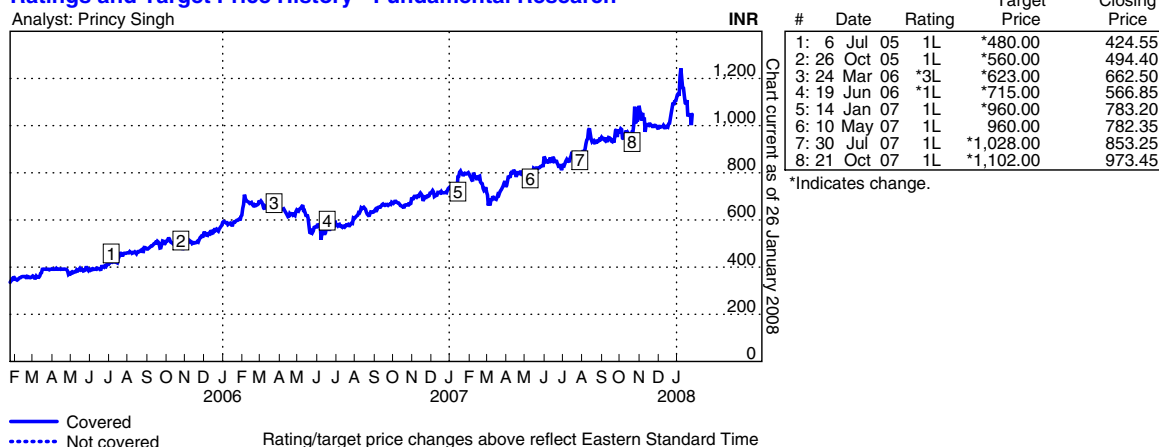
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Analyst: Princy Singh



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Data current as of 31 December 2007

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